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COMMENTS ON DRAFT STATE BUDGET LAW

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Executive Summary

This document provides comments on the draft State budget law of the Republic of Viet Nam. The comments were prepared as part of the Governance for Inclusive Growth (GIG) Program, funded by USAID. The general objective of the GIG project is to enhance governance to facilitate broad-based sustainable growth. Specifically, it seeks to improve the accountability of public institutions; one of the activities that contributes to this goal is to strengthen the role National Assembly and its Budget and Finance Committee in the budget process and to develop the internal capacity of the Committee to conduct budget review and analysis.

The following comments were prepared by Mr. Richard Emery, an international consultant in public finance. Mr. Emery visited Viet Nam from 18 July 2014 to 2 August 2014. During his visit he and Ms. Hoang Thuy Nguyet, senior lecturer of National Institute for Finance, GIG local consultant for this project, presented a workshop on budget review and analysis for the staff of the Committee on Financial and Budgetary Affairs of the National Assembly and staff from selected provincial Peoples Councils. In addition to the workshop, Mr. Emery participated in a series of meetings to learn more about Viet Nam's budgetary procedures. The following document reflects input from these meetings. Discussions with Nguyen Minh Tan, Vice Director of NA Finance and Budget and with Ms. Nguyet, were particularly informative.

The comments also benefit from a review of the 11 March, 2014 draft State Budget Law, the Final Constitution of the Republic of Vietnam Adopted by the National Assembly 28 November, 2013, the World Bank "Review of the State Budget Law, 2002, and the reports of the US AID Star Plus Project.

The document incorporates comments on the paper developed in a meeting with NA Finance and Budget. The discussion was led by Nguyen Minh Tan, Vice Director of NA Finance and Budget and reported by Ms. Nguyet. Comments are shown at the end of the recommendations in italics.

Background

The Constitution of Viet Nam creates a broad framework for the budget (Article 55), identifies duties and powers of the National Assembly (Article 70) and requires Government to propose the draft budget (Article 96). The National Assembly is charged with deciding on the objectives for socio-economic development and deciding on national financial and monetary policies, including:

- Setting, changing or abolishing taxes,
- Deciding on the allocation of income and expenditures between central and local governments,
- Limiting national debt,
- Planning the allocation of the State budget, and
- Approving the accounts of the State budget.

The draft State Budget Law expands on these functions, particularly in Article 17, which itemizes the budget functions of the National Assembly.

The comments below are divided among eight topics. For each topic current provisions are summarized, followed by recommendations for revisions to the law to strengthen the National Assembly's functions, enhance transparency and / or improve accountability. The rationale for the recommended changes is provided for each recommendation.

Overview of Recommendations

The World Bank, the US AID Star Plus Project and the Donor Group have all provided useful comments on the draft State Budget Law. This document focuses directly on issues of concern to the National Assembly and particularly on the objective of strengthening the budget process from the perspective of the Committee on Financial and Budgetary Affairs. Recommendations address the following eight topics:

1. Budget Functions of the National Assembly and its Committees
2. National Assembly Budget Review
3. Medium and Long-Term Planning
4. Estimates of Revenues
5. Strengthening Budget Process at Central, Regional and Local Levels
6. Transparency and Accountability
7. Develop State Accounting System
8. Results Based Budgeting

These recommendations have been discussed in concept with the Committee staff during the workshop on budget review and analysis presented in Da Nang.

I. Budgeting functions of the National Assembly

Article 17 of the draft State Budget Law itemizes the “Duties and powers of the National Assembly”. The statute presents a comprehensive set of law making, budgeting, and oversight functions for the National Assembly, including the following:

- Making and amending laws in the financial and budgetary field
- Deciding on the Medium Term Financial Budgetary Plan
 - Policies for revenue collection
 - Expenditure policies
 - Allocation among:
 - Ministries
 - Provinces, and
 - Between recurrent and investment spending
- Budget review to:
 - Determine consistency with framework
 - Decide on the investment policies for nationally important projects and programs
 - Decide on the allocation of the central budget
 - Approve functional / program allocation
 - Determine allocations from the central budget to local budgets of each locality including revenue sharing percentage, balancing additions and targeted additions
- Supplemental budget
 - Revisions to authorize spending revenues in excess of budget
 - Revisions to reduce spending to reflect budget shortfall
- Budget oversight

Recommendations:

1. *Clarify the amendment powers of the National Assembly on the budget* – Add an article to the State Budget Law specifying the amendment powers of the National Assembly. In some countries, amendments increasing budget allocations must be offset by spending reductions elsewhere or by revenue increases. In budget law 2002, Vietnam set up a rule like that (Article 4) Other countries allow amendments within levels approved in the Medium Term Financial Budgetary Plan or Medium Term Expenditure Framework. Still other countries prohibit amendments to the Government’s budget proposal. The State Budget Law should explicitly define amendment powers. *NA prefers to allow amendments within approved levels in MTFF.*
2. *Require a supplemental budget approval for spending revenues in excess of the approved budget* – Article 56 of the draft State Budget Law establishes procedures for increases or decreases in revenue and expenditures compared to the approved budget. This language should be modified to require that a supplemental budget be presented to the National Assembly for approval for any revision beyond limited financial reserves approved in the budget. The National Assembly should approve budget revisions. *This would be difficult for Vietnam at this stage because the capacity for estimating revenues and expenditures is still very weak. Because of this limitation, the Government has been given the power to use the excess revenues and the saved expenditures at the central level and to report to the National Assembly Standing Committee for comments before execution.*
3. *Expand oversight to strengthen budget law implementation* – Article 17 provides for the National Assembly to oversee the realization of the State budget. This authority should be implemented by reviewing the quality of estimates of ministries and provinces, reviewing Provincial budget procedures, including the implementation of budget law, the quality of estimates developed for the province, and budget process issues, and through reviewing implementation of performance management. This could be implemented by holding hearings in the Provinces, to study local procedures.

II. National Assembly Budget Review

The National Assembly budget review functions are itemized in the draft State Budget Law. Budget review includes review of the budget framework, analysis of the annual budget, review of monitoring reports, oversight of budget realization and approval of the State budget final accounts. These functions are identified in Article 17 on the “Duties and Powers of the National Assembly” and throughout the law in the reporting and implementation requirements for the budget. Article 44 identifies the “Documents to be submitted on State Budget...”, including:

- a. Assessment of execution of current budget
- b. State budget revenue forecasts
- c. State budget expenditure estimates, including objectives of important programs to the economy and key policies
- d. Budget deficit and financing sources

- e. Medium Term Financial Budgetary Plan for the first year of the planning period
- f. Lists of nationally important programs
- g. Budget estimates of each ministry, and transfers to provinces

The law should be clarified to make it clear that budget review continues throughout year. Requirements for budget content should be expanded to support the National Assembly's review requirements.

Recommendations

1. *Review prior year's budget performance* - Inclusion of historical information in budget provides a basis for comparison to the expenditure and revenue estimates of current and prior years. Most countries budget documents present tables showing prior year actuals, updated current year estimates, and proposals for the current year on a comparable basis. Tables in the budget should facilitate review of prior year budget performance. *NA agrees to put this idea clearly in the revised budget law.*
2. *Develop baseline – focus on new policy* – The budget document should include current policy or current services estimates for spending and revenues, assuming no change in budget policy. This data should be used to highlight the impact of policy changes, new programs or changes in tax law on the budget. The National Assembly budget staff should focus its review on developing and accurate estimate of baseline requirements and the implications of proposed changes in policy. *MTFF and MTEF are tools for NA to review. GIG could provide assistance to the NA by describing more clearly what a baseline is and the procedures for government and NA to do rolling baselines each year. If an advisor from the US Congressional Budget Office is brought to Viet Nam, that advisor could work with the Committee to develop baseline estimates.*
3. *Draft budget law* – The budget document should include a draft budget law for the National Assembly's consideration. The draft budget law should establish allocation to ministries and between central and local governments. It should also provide clear guidance on authority for and limitations on subsequent budget revisions. If Vietnam adopts two-step budgeting, NA could review the MTFF or MTEF (see the paragraph below under Medium-Term Budgeting) in the first step (in May) and consider the detailed budget law in the second step (in November).
4. *Require standard budget classification revenues and expenditures for all levels of government* – The State Budget Law should require standard budget classification for administrative units, budget functions and major economic classifications for all levels of government. *NA would like to put this idea in national resolution, not in the budget law, because changing the classification takes a lot of time and financial resources. NA will take your advice and talk with the treasury on this.* To the extent possible, these classifications should reflect international standards such as the GFS 2001 standards produced by the IMF. Standardization will facilitate budget review

and monitoring. Programs defined in implementing results based budgeting would not be standardized, but expenditures for these programs would be categorized by organization, function and economic classification. Budget monitoring reports and budget accounting should use the same classification structure to the maximum extent possible.

5. *Require supplemental budgets for changing budget requirements* – All spending should require authorization in law. Budget reallocation from reserves or by administrative action should be limited to legally established reserves. All other budget revisions should be approved by supplemental budget proposals presented to and approved by the National Assembly. *NA agrees with this proposal.*
6. *Require Mid-Year Budget Review* – The Government should prepare a Mid-Year Budget Review. The Mid-Year review should reflect updates to economic assumptions, revised revenue and spending estimates and comparisons between the approved budget and budget implementation to date. The review could be submitted at the end of the first session of the National Assembly or the beginning of the second session. Revised budget requirements should be submitted in the form of supplemental requests in the context of the Mid-Year review. *NA agrees with this proposal.*

III. Medium and long-term planning

The draft State Budget Law provides for a Medium Term Financial Budgetary Plan for the first year of the planning period to be included in the budget. The Ministry of Planning and Investment is required to submit a medium term socio-economic development plan and to coordinate with the Ministry of Finance in preparing the State budget and the central budget allocation plan. There is no requirement to use the Budgetary Plan to control budget allocations or for coordination between the Budgetary Plan and the SEDP.

The labels “Medium Term Financial Budgetary Plan,” “Medium Term Fiscal Framework,” and “Medium Term Expenditure Framework” are used interchangeably, with countries choosing one term or the other, but without a standard definition of the differences among the labeled plans. The current Medium Term Financial Budgetary Plan is not binding. It does not establish expenditure ceilings for components of government. The draft law does not specify what it should contain. The recommendations below specify the assumptions that should be legislated.

Recommendations:

1. *Establish a requirement in the State Budget Law for a Medium Term Expenditure Framework* – The State Budget Law should be revised to create a requirement for a MTEF to plan and structure budget decisions. The MTEF should be for a minimum of the budget year plus two succeeding years. It should be updated annually to reflect revised economic conditions and changing policy considerations.



The MTEF should provide limitations on budget allocations among ministries and provinces and for major economic classifications of the budget. *As mentioned above, MTEF and MTFF are quite new in Vietnam, so please indicate more details on these concepts, especially details on the fact that, each year, NA still has to do rolling MTFF and MTEF. NA thinks it is impossible to put it in law because of the uncertainty due to changing social and economic circumstances.*

2. *The MTEF should be submitted to the National Assembly for approval at the beginning of the first session each year* – Early submission would involve the National Assembly in the early stages of budget formulation and policy formulation at the broadest level of budget policy. Decisions about budget aggregates and allocations among ministries and provinces would govern development of detailed budget submissions. Earlier guidance would facilitate detailed budget development. *NA thinks it is impossible to put it in law because of the uncertainty due to changing social and economic circumstances. (While social and economic circumstances change, they do not change to a great extent within one year for most governments.)*
3. *Responsibility for developing macro-economic assumptions* – Responsibility for macro-economic assumptions would be shared between MPI and the MOF. MPI would ensure that assumptions were integrated into the SEDP. The MOF would develop an assessment of the fiscal impact for the MTEF. The MOF would develop revenue, debt, and expenditure estimates based on the new forecast. The economic assumptions would be approved as part of the MTEF and provided to all budget users to serve as the basis for their budget estimates. *NA agrees with this proposal.*
4. *The State Budget Law should specify the contents of MTEF* – The MTEF should include:
 - Macro-economic forecast
 - Medium term fiscal outlook
 - Budget aggregates for revenues, expenditures, and debt
 - Allocation among ministries and between recurrent and investment spending
 - Allocation to provinces and between recurrent and investment spending
5. *The MTEF should become a binding framework for budget planning* – The law should require coordination between the SEDP and the MTEF. The SEDP should be limited by this fiscal framework. Investment proposals should reflect priorities set in the SEDP. Ministries and provinces should be limited to budget constraints set in the MTEF.

IV. Estimates of revenue

The lack of accuracy in revenue estimates at the central and local levels of government undermines the reliability of the budget and the authoritativeness of the allocations made in the budget. Improving revenue estimates could improve the accuracy and reliability of the budget and reduce the volatility of budget estimates. Articles 33, 35,

and 38 of the draft State Budget Law establish requirements for revenue sources for the central budget, local budgets and for determining budget balancing additions, targeted additions and revenue sharing percentages. The provisions are complicated and resulting allocations non-transparent. The interaction among the requirements may provide incentives for underestimating revenues and result in a lack of budget certainty.

Recommendations:

1. *Consider identical tax sharing revenues compensated with higher or lower intergovernmental transfers* – The World Bank Review of the State Budget Law suggested adopting a standard tax sharing formula for all provinces to simplify revenue estimates. Higher or lower balancing additions and targeted additions could be implemented to result in the planned distribution. *NA thinks it is impossible to put it in law because of the uncertainty due to changing social and economic circumstances.*
2. *Consider adopting current law baseline adjusted for policy changes* – As an alternative to estimating future revenues, consider basing revenue sharing allocations on prior year actual revenues, adjusted for changes in policy. Rather than forecasting future revenues, base allocations on revenues collected in the most recent actual year. Again the resulting allocations should be simpler and should have less uncertainty due to changing economic circumstances. *NA agrees with this proposal.*
3. *Specify criteria for determining transfers in State Budget Law* – Whatever criteria are used they should be set forth as simply as possible in the State Budget Law. The criteria should be changed as little as possible from year to year to provide stability in intergovernmental transfers. Greater transparency is needed. *NA thinks it is impossible to put it in law because of the uncertainty due to changing social and economic circumstances*
4. *MTEF allocations among provinces will enhance transparency* – Providing allocations among provinces earlier in the process and making those allocations binding will facilitate budget formulation in the localities. *NA agrees with this proposal.*

V. Strengthen budget process at central, regional and local levels

Schedule - Article 41 establishes the schedule for the Viet Nam's budget process. It begins no later than May 31 with the Prime Minister issuing guidance for the development of the SEDP. The budget is submitted to the National Assembly by September 25th and approved by November 15th. Between November 15th and December 31, Ministries and local governments must complete detailed allocations of the budget. Schedule

Budget authority – The National Assembly “decides on the State budget estimate”. It is not clear that it enacts a law implementing the budget. Article 10 authorizes each budget level to allocate 2% - 5% of total expenditures for contingencies. Article 11 authorizes a financial reserve fund at each level of not to exceed 25% of expenditures

for total advances. Article 54 allows advances from next year's estimates, borrowing from future allocations. Article 55 allows settlement of temporary State budget deficits, to be refunded within the budget year.

Budget coverage – All expenditures and revenues of government are required under the Constitution (Article 55.2) to be included in the budget. International standards require expenditures and revenues to be included on a gross basis, without offsets. In Viet Nam this should apply to education and hospital fees and to the transactions of state owned enterprises. All revenues and expenditures should be controlled through the budget.

Execution authority – Article 50 establishes authority for adjustment of budget estimates already assigned to budget using units. The language describes procedures, but does not limit transactions. MOF guidelines almost certainly establish further requirements providing execution authority and establishing reporting requirements.

Recommendations:

1. *Revise schedule to ensure minimum essential time at all levels* – As noted above; the MTEF should be enacted in pre-budget during the first session of parliament. The MTEF would specify aggregates and the allocation to ministries and provinces by recurrent and investment categories. Early decision on guidance levels will facilitate budget formulation. *NA is thinking about two steps of budgeting within a year.*
2. *People's Committees for localities should be required to submit budgets to their Peoples Councils within budget limits set in MTEF, concurrent with Government's submission to the National Assembly.* Beginning budget formulation within the localities earlier provides more time for budget policy discussions and should improve the quality of local budget estimates. *NA agrees with this proposal.*
3. *Make budget more authoritative* – The MTEF should be binding on budget submissions for ministries and provinces and for allocations between recurrent and investment budgets. *NA agrees with this proposal.*

VI. *Budget flexibility for the enacted / approved budget should be reduced* – The World Bank analysis pointed out that much of the flexibility authorized by the draft State Budget Law has no corollary in most countries budget systems. Reserves should be centralized and managed centrally. Carryovers should be limited in scope. Borrowing from next year's budget should be ended or limited greatly. Revisions to the approved budget should require supplemental approval from the National Assembly. The combination of defining the MTEF as binding and limiting flexibility throughout the budget would result in a more authoritative budget. The enacted budget should be treated by the National Assembly and by Government as binding. *NA agrees with this proposal.*

VII. *Clarify budget execution authority in State budget law* – Legal authority for budget revisions should be clearly established in the State Budget Law. It should establish thresholds for vierments / re-appropriations, maximum reallocation without approval from the MOF, maximum reallocation with the approval of the MOF, amounts and conditions requiring supplemental approval from the National Assembly. As noted under budget review a

standard budget classification should be required. Budget, reporting and accounting should be developed and reported using the same standards. *NA agrees with this proposal.*

VI. Transparency and Accountability

Article 44 of the draft State Budget Law describes documents on State budget estimates that are to be submitted to the National Assembly. A Medium Term financial budgetary plan is required to be included among those documents. Article 57 requires periodic reports on the status of State budget execution. It does not specify timing or frequency. There is no requirement in the draft law for a Mid-year update on the budget. There are also no requirements for public release of budget reports.

The revenue sources and expenditure responsibilities of localities, provinces and the state are not clearly separated in the draft State Budget Law. The language seems to be overlapping, rather than providing a distinct set of responsibilities by level of government. Accountability will require clear assignment of responsibility.

Recommendations:

1. *Add requirements to the State Budget Law specifying the form and content, schedule and public availability of budget documents:*

- MTEF:
 - Transmittal at the beginning of 1st Session of parliament.
 - Content:
 - Macro-economic forecast
 - Medium term fiscal outlook
 - Budget aggregates for revenues, expenditures, and debt
 - Allocation among ministries and between recurrent and investment spending
 - Allocation to provinces and between recurrent and investment spending
 - Explanation of macro-fiscal policies of government
- Budget:
 - Transmittal at the beginning of 2nd Session of parliament
 - Content:
 - Assessment of execution of current budget
 - Macro-economic assumptions, including an explanation of any changes from the MTEF
 - State budget revenue forecasts
 - State budget expenditure estimates, including objectives of important programs to the economy and key policies
 - Budget deficit and financing sources



- Lists of nationally important programs
 - Budget estimates of each ministry
 - Transfers to provinces
 - Draft budget law
 - Standard budget classification for administrative unit, functional classification, and major economic category
- Mid-year update:
 - Transmittal two weeks before end of first session of parliament - around June 15th
 - Content:
 - Updated macro-economic forecast
 - Revised estimates of revenues and expenditures compared to approved budget
 - Explanation of significant differences
 - Supplemental budget requests, if needed, to seek approval for budget revisions
- Monthly / Quarterly monitoring reports:
 - Transmittal within 30 days of the end of the period
 - Content:
 - Actual budget revenue and expenditure by major administrative unit
 - Comparisons to approved budget
 - Borrowing and debt compared to approved budget
- End-of-year reports:
 - Transmittal within 30 days of the end of the period
 - Content:
 - Actual budget revenue and expenditure by major administrative unit
 - Comparisons to approved budget
 - Borrowing and debt compared to approved budget
 - Explanation of significant variance from approved budget
- Audit report:
 - Transmittal of final audited results by Government is required by 14 months after the end of the budget year
 - Contents:
 - Consolidated financial statement for the government
 - Identification of audit exceptions

- Recommendations for corrective action
 - State Audit of Viet Nam should submit its report and recommendations by 15 months after the end of the budget year (NA will take your advice into consideration.)
- 2. *All budget reports should be released to the public when transmitted to the National Assembly* – The State Budget Law should require public release of budget reports. In many countries budget reports are released on the internet at the time of their release to the parliament. Budget documents are also made available to the press and presented in press conferences at the time of their release.
- 3. *Clarify and simplify budget responsibility among levels of government* – Accountability will require clear assignment of responsibility for budget execution. The pending law on Local Governance may resolve the overlap in responsibility among levels of government. If not, the language in the State Budget should be modified to provide clear distinctions.
- 4. *Require periodic reporting and monitor results* – Accountability will be enhanced by requiring periodic reports and monitoring the results reported in those documents. Reports will be improved by ensuring consistency of budget data.

VII. Develop State accountability system

Articles 63 through 67 provide requirements for accounting for the budget. This legislation would augment the Law on Accounting of 2003. I have not reviewed the Law on Accounting. Accounting should facilitate budget reporting and execution and strengthen budget implementation.

RECOMMENDATIONS:

1. *Implement accounting system under Accounting Law* – Accounting requirements are established by the MOF, under the Accounting Law. Public sector accounting is inherently different from enterprise accounting, primarily because the public sector does not achieve and is not expected to achieve profits. Standards for public sector accounting in many countries are established by an independent board of public sector accountants working with the MOF. The standards should to the extent possible meet international accounting standards. International Public Sector Accounting Standards (IPSAS) are established and maintained by the International Federation of Public Accountants. NA does want to have full information of the financial status of the public sector.
2. *Mandate standards at all levels of government* – All levels of government should be required to use the same standards. The standards should be developed and maintained by the MOF. *NA agrees with this proposal.*
3. *Require consistency between budget classification and accounting* – The State Budget Law should require consistency between budget classification and accounting requirements. *NA agrees with this proposal.*

VIII. Results based budgeting

Article 27 setting forth the duties and powers of ministries ... and other central agencies requires them to issue the technical and economic standards to set the grounds for performance-based budget management in the fields and sectors of which they are in charge. Article 29 requires Peoples Committees to prepare and allocate performance-based budgets “as stipulated by the Government”.

There are no requirements for the Ministry of Finance to develop government-wide guidelines for implementation of performance based budgeting. There are also no requirements for submission of a performance-based budget.

Implementation of performance-based budget in most countries has been a long involved process that requires guidance, training, and technical assistance. Few parliaments have actively supported performance based budgeting. This tool or set of tools requires is best served by an incremental implementation approach.

Recommendations:

1. *Require MOF to develop implementation strategy* – The MOF should be directed in the State Budget Law to develop guidelines for implementing performance based budgeting. The MOF should work with the line ministries to develop pilot efforts in defining program objectives, identifying performance measures, measuring performance and documenting results. In Thailand the Bureau of the Budget, the central budget office, established a technical assistance office to work with line ministries to support implementation of performance based budgeting.
2. *Require MOF to report to NA on implementation with recommendations for further refinements* – The MOF should be required to report to the National Assembly periodically on progress in implementing performance based budgeting. NA prefers to have the report on performance from Line ministries, not from MOF.
3. *NA oversight of implementation of results oriented budgeting* – The National Assembly sectoral committees should hold oversight hearings on implementation of performance based budgeting by line ministries. Particular attention should be given in these hearing to the statement of objectives of programs and identification of measures of success. These issues are policy questions that are frequently not defined clearly in statute. The Committee on Financial and Budgetary Affairs should oversee the MOF effort to lead the effort and could consider holding hearings with provinces to review how the provinces are implementing performance based budgeting.